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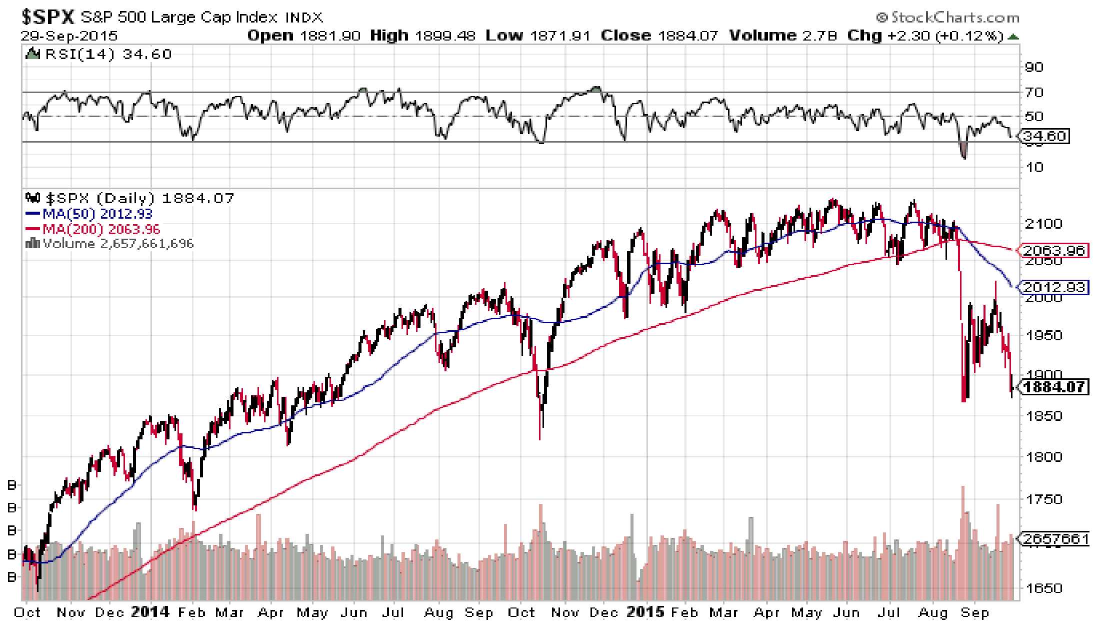
Retesting the August Lows
9.29.2015



I'm certainly feeling a lot better about markets in general after the recent decline. The decline has been severe enough to warrant some positive attention.

There has been very persistent selling over the past few weeks that have pushed my indicators to an extreme whereby stocks may be bottoming out. While I believe it's probable we are in a Bear Market for stocks (a market that declines by 20% or more) and that the US stock market made a major top in 2015 we can still have strong interim rallies especially in the late October thru December months.

At present we have a truly significant amount of investor fear where almost none existed two months ago and my guess is that will set us up for a year- end rally in US equities. It would be my guess that most of the investor angst due to falling commodities and a slowing US economy appear to be peaking. There is a caveat to this premise and that is there is a better than 50-50 chance the US will enter into a recession in 2016. Not for one bit do I believe investors have priced a recession into US markets so any rally we experience will likely be short lived.

Fortunately for us we missed most of the August waterfall decline which left portfolios with a very high percentage of cash. Since I believe we'll experience a rally into December we've been slowly buying shares of companies in which the value of the company on the open market is very compressed relative to earnings and its balance sheet. These are companies that have already fallen 30% or more and are very close to their Enterprise Value "EV".

(Enterprise value is the present value of a company's stock and debt combined minus the cash on their balance sheet) When companies are acquired the purchase price is normally at a premium to the EV.

While I do believe the US markets should rally into December based on the significant amount of investor fear, we cannot rule out the rally could start from a lower level brought upon by another wave of stock liquidations. That being said we're also building a position in US Treasuries that will buffer our equity holdings and will also place our portfolios in position for a potential US recession.

At present I would prefer to own mid to long term Treasuries rather than using a "short" exchange traded fund to hedge because I believe the Treasuries offer a long term solution to either further emerging market or US market weakness plus they'll be The Go To investment should we fall into recession.

Last month I mentioned that the months of September and October are notorious for market weakness and October is the month when most major selloffs bottom out whereas November and December are usually very positive. Chart 2

Major market moves up or down seldom occur when everyone is looking for it to occur, they occur when investors are caught leaning too much in the opposite direction. For example, the Equity Hedging Index produced by sentimentrader.com is presently the most positive since 2011. Chart 3

Chart 2

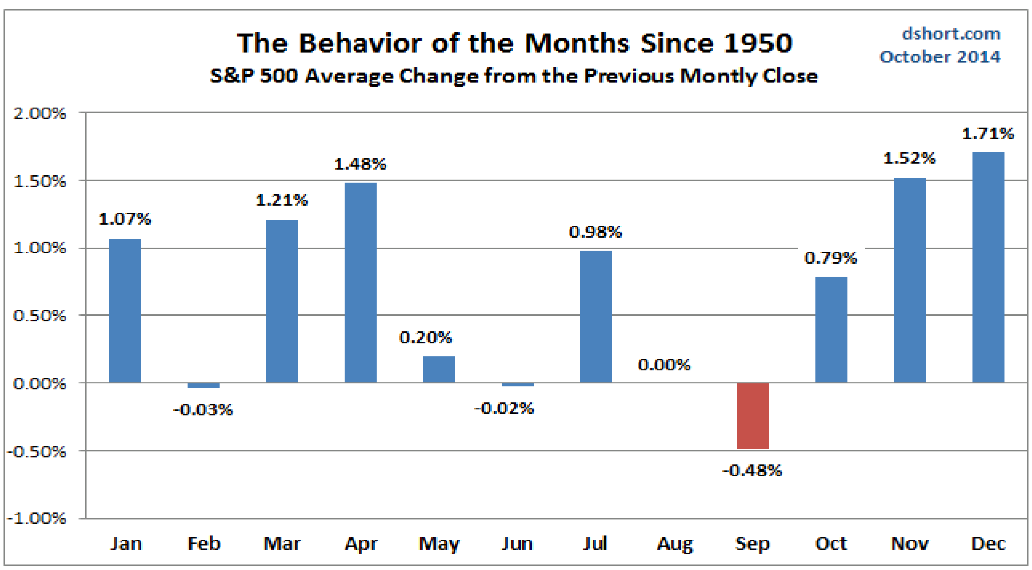
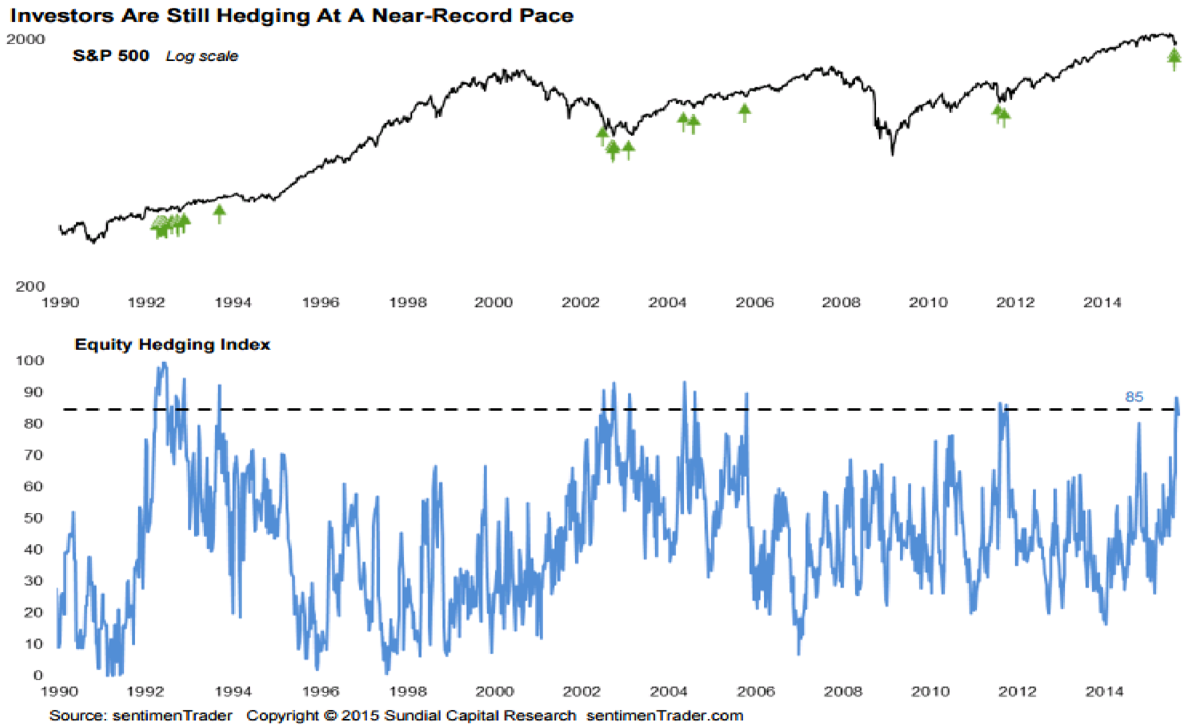
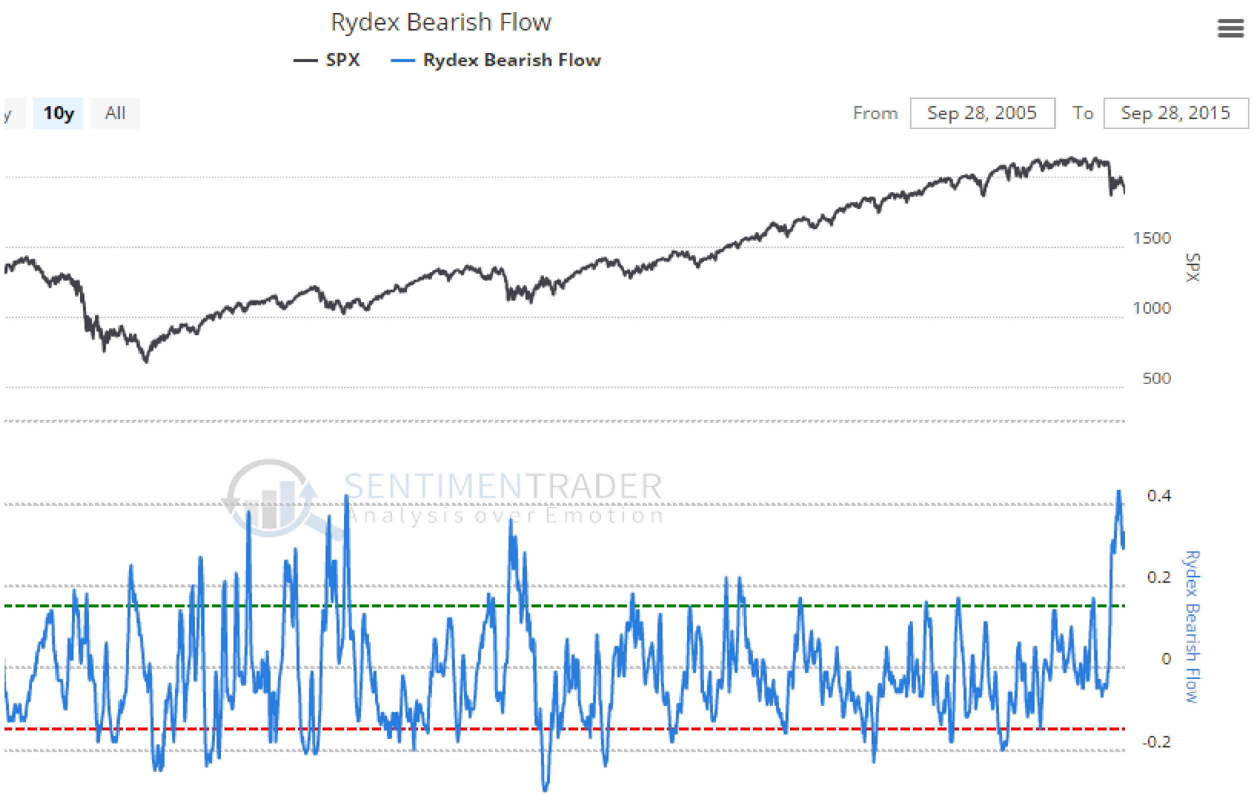


Chart 3



Investors Are Still Hedging At A Near-Record Pace
2000
S&P 500 Log scale
200
1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014
Equity Hedging Index
100
90
80
70
60
50
40
30
20
10
0
85
1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014
Source: sentimenTrader Copyright © 2015 Sundial Capital Research sentimenTrader.com

In addition, typical wrong way traders are flooding into the Rydex Bearish mutual funds at a level typically seen at market bottoms. Chart 4



At present we are beginning to nibble with just partial positions in Deep Value stocks but I am not willing to exceed a 50% weigh in equities in accounts until further overall market improvement.

By "Deep Value" I'm referring to companies that are selling either below liquidation or acquisition price. The target appreciation for these kinds of investments is usually in excess of 30% or more if successful. These kinds of stocks are hard to come by when markets are moving higher but they become more common as markets decline. These are companies with very strong balance sheets, they usually have a great deal of cash on their books and frequently pay attractive dividends: TrustCo Bank Corp NY symbol TRST is a very good example.

Kulicke and Soffa Industries KLIC - Semiconductors

Stock Price $9.21
Enterprise Value "EV" $201mm (Total value of the company including stock and debt minus cash)
Operating Cash Flow "OCF": $74mm

Earnings Yield: Operating Earnings divided by Enterprise Value = 37.6%*

To understand how an acquirer of would look at KLIC they would look at the present value of the EV and compare that to the OCF and raise their eyebrows at the 37.6% yield on the present values.   So they could offer a premium to the shares or premium to the EV in an offer to buy the entire company.   The value of the company will usually not stay this low for an indefinite time period before a competitor or another party attempts to buy them.

Computer Task Group symbol CTG – Information Technology

Stock Price $6.19
Enterprise Value $65mm
Dividend 3.8%
Operating Earnings $11mm

Earnings Yield: Operating Earnings divided by Enterprise Value = 23.8%

<u>This type of investing does take patience and has a much longer time horizon than the investing we've done in the past 3-4 years. We have been able to quantify these companies and investments and in testing the profitable trades were held on average in excess of one year. Thus most of our future gains will be consider tax friendly long term gains.</u>

Long KLIC and CTG

Brad Pappas